1 ACCOUNTING FOR AMALGAMATIONS AND CORPORATE RESTRUCTURING

Topic 1 : Amalgamation of Companies

Preamble

The term “amalgam” means to unite, to come together as one, or to blend, and, from this root, the accounting terminology of ‘Amalgamations’ is derived. The popular meaning of “amalgamation” is the dissolution of one or more companies and transfer of business of dissolved entities to another entity. Companies and business entities come together to form a single entity for various reasons, including but not limited to the objective of effecting tax savings. It is essential to be well versed with the accounting treatment to be accorded for such transactions.

Scope

What is taken care of by AS 14 is an amalgamation pursuant to the provisions of the Companies Act, 1956, or any other statute, which may be applicable to companies. In a number of UK (also Indian) cases, the Courts have decided that this terminology includes 'absorption' as well. The popular meaning of “absorption” is the acquisition of a business by an existing company. Consider the position in the following table.

Amalgamation (does not cover acquisition)	*Absorption*
• Status of a separate legal entity of two or more entities vanishes – a new entity emerges	• Status of a separate legal entity of one or more entity vanishes – one existing entity takes over
• If X Ltd. and Y Ltd. are liquidated and a newly formed Company Z Ltd. acquires the two businesses, it is termed as amalgamation.	• If X Ltd. is taken over by Y Ltd. it is referred to as 'absorption'. Here there is no formation of a new entity, but there are one or more liquidations.
• X Ltd. and Y Ltd. are transferors, Z Ltd. is transferee	• X Ltd. is transferor; Y Ltd. is transferee

It is safe to assume that the connotation of the term amalgamation also include absorption.

Coverage under AS 14 excluded

There are circumstances in which one company can obtain control over another, without impinging upon the status of each company being an independent and separate “legal entity”, and yet deriving the benefit of “coming together” by acting as one single “economic entity”. Accounting treatment for such situations is covered by the pronouncements under AS 21 –

Consolidated Financial Statements.

Important terms - defined

- ***'Transferor Company'*** means a company, which is amalgamated into another company. The company selling its business is also called "**Vendor Company**".

- The company into which a transferor company is amalgamated is called the ***"Transferee Company"***. The Company which acquires (or buys) the business is also called the "**Vendee Company**".

Business entities coming together

Generally speaking, there are two basic “methods” in which business entities unite together. In this backdrop, the Standard brings the concept of amalgamation under two broad heads (Merging or Purchasing).

a. First is **'amalgamation in the nature of merger'**. Under this category, there is a genuine pooling

   ⇒ not merely of the assets and liabilities of the amalgamating companies

   ⇒ but also of the interests of shareholders and of the business of these companies.

b. Second is **'amalgamation in the nature of purchase'**. Transactions under this category are in effect

   ⇒ a mode by which one company acquires another company, and

   ⇒ as a consequence, the shareholders of the company which is acquired normally do not continue to possess interest in the equity of the combined company in an identical proportion, to that held by them in the liquidated company. Also the business of the company, which is acquired, is not necessarily intended to be continued.

Amalgamation in the nature of merger

What distinguishes a “merger” from a “purchase”, is the true substance of the transaction. It is helpful to know that the UK-Financial Reporting Standard 6 deals with “merger”. Relevant excerpt from FRS 6 is furnished below

> ***"Merger is a business combination which results in the creation of a new reporting entity formed from the combining parties, in which the shareholders come together in a substantially equal partnership for the mutual sharing of risks and benefits of the combined entity; and in which no party to the combination, in substance, obtains control over any other.. .. .. ..”***

AS 14 enumerates five specific conditions, on fulfillment of which the event of two entities coming together is to be treated as "amalgamation in the nature of merger".

Five Conditions

- **All the assets and liabilities** of the transferor company (for brevity referred to as SC) become the assets and liabilities of the transferee company (for brevity referred to as PC)
- Shareholders of SC holding **not less than 90% of the "face value" of equity shares** become the shareholders of PC by virtue of amalgamation. For the purpose of computing 90%, exclude shares already held prior to amalgamation, by:

  ⇒ PC in the SC
  ⇒One or more subsidiaries of PC in the SC, and
  ⇒Nominees of PC in the SC
- The **consideration** paid to equity shareholders of the SC is **in the form of equity shares** in the PC, except that cash may be paid in respect of any fractional shares.
- The **business of the SC** is intended to be carried on, after the amalgamation, by the PC, and
- Assets and liabilities of SC are incorporated in the financial statements of the PC at **book values** except to ensure uniform accounting policies. Thus, if SC is following straight-line method of depreciation and the PC is following written down value method, the book value of the assets of SC will be revised by applying written down value method. This would ensure adoption of uniform accounting policy for the pooled assets.

Consider the following example of A Ltd., and B Ltd., who come together by forming AB Ltd. Consideration is paid by way of shares in AB Ltd.

Rs. in Lakhs

Particulars	*A Ltd*	*B Ltd*
Share capital	100	150
Retained earnings	80	120
Loans, creditors and payables	115	110
Total liabilities	***295***	***380***
Fixed assets	175	260
Current assets including bank balance	120	120
Total assets	***295***	***380***

Assume that AB Ltd. issues shares for Rs.250 of which $2/5^{th}$ will go to A Ltd., and $3/5^{th}$ will go to B Ltd. The balance sheet of AB Ltd. will emerge as under.

Rs. in Lakhs

Particulars	*AB Ltd*
Share capital	250
Reserves	200
Loans, creditors and payables	225
Total liabilities	***675***
Fixed assets	435
Current assets including bank balance	240
Total assets	***675***

[Note: In practice, however, the mergers would be a much more complex affair than the much-simplified version presented as example].

Amalgamation in the nature of purchase

What is not a merger, is a purchase.

If any one or more conditions pertaining to 'merger' listed in the earlier paragraph are not satisfied, then it is a case of amalgamation in the nature of purchase. *Even if one condition of merger is not satisfied, it amounts to purchase*.

Method of Accounting

Nature of Amalgamation	*Method of Accounting*
Merger	Pooling of Interest method
Purchase	Purchase Method

Pooling of Interest method

There are three salient features:

1. In preparing financial statements of PC, the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the SC should be recorded at their existing carrying amounts and in the same form as at the date of amalgamation. The balance of the profit and loss account of the SC should be aggregated with the corresponding balance of PC or transferred to *'General Reserve'*, if any.

   Note : The "Expert Advisory Committee" have given an opinion that if the consideration is less than the paid up capital of the transferor company, the difference is to be treated as "*capital reserve*" since it is more in the nature of share premium. Such capital reserve will neither be eligible for dividend nor declaration of bonus.[Refer Problem 5]

2. If at the time of amalgamation, the transferor and transferee companies were to have accounting policies that are conflicting, such conflict is resolved, and brought in line with the policy adopted by PC. A *uniform set of accounting policies should be adopted* following the amalgamation. The effect of any changes in the accounting policies on the financial statements should be reported in accordance with AS-5.

3. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of the share capital of the SC should be adjusted in reserves. Accordingly*, no goodwill or capital reserve,* will arise out of amalgamation by way of merger. Courts may nevertheless stipulate (in some circumstances), the manner in which reserves should be adjusted or reported. This should be followed.

Purchase Method

The object of purchase method is to account for amalgamation by applying the same principles as are applied in any normal transaction involving purchase of assets. Accordingly, the following rules are adopted in this method.

1. The assets and liabilities (but not the reserves) of SC are incorporated in the financial statements of PC at existing carrying amounts. Alternatively, the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their *fair values* at the date of amalgamation. *Fair value is defined in AS 14 in the same way as defined under AS 13.*

2. Identity of *non-statutory reserves* (whether capital or revenue or arising on revaluation) of the SC is not preserved, and hence such reserves are *not to be included* in the financial statement of the PC.

3. If the purchase consideration is more than the net assets, the difference should be debited to *goodwill account*. Conversely, if the value of net assets is more than purchase consideration, the difference should be credited to *capital reserve account.*

4. The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life. The amortisation period should not exceed five years unless a somewhat longer period can be justified.

5. Where the requirements of relevant statute so demand, "Statutory reserves" of SC should be recorded in the financial statements of the PC. While crediting the statutory reserve, debit is given to **'Amalgamation Adjustment Account.'** This account should be disclosed in the balance sheet under the heading '*Miscellaneous Expenditure'*. When the legal requirement no longer warrants maintenance of such a reserve, a reversal entry is passed debiting the statutory reserve and crediting the 'Amalgamation Adjustment Account'.

The important differences between the two methods of accounting are summarised below:

Particulars	*Pooling of Interest*	*Purchase*
Discharge of purchase consideration	Mainly shares; cash for settling dues of fractional shares	Shares, or other securities, or cash
Assets and Liabilities	Recorded at book values	Recorded at Fair values
Reserves	Are brought into and recorded in the books	Only statutory reserves are recorded by debit to Amalgamation adjustment account (reversed when statutory conditions are met)
Difference between consideration and net value of assets	Not recorded – difference is adjusted against reserves	Recorded as goodwill or capital reserve

Three areas having linkage

a) Non-cash consideration

Consideration for any transaction may partly or solely comprise "non-cash" element. (AS 10 and AS 13 also touch upon this aspect). In a purchase or merger, consideration paid to SC may include securities or other non-cash elements. Four aspects have to be kept in mind.

- Such non-cash component must be valued at *fair value*.
- If securities are issued, value fixed by the statutory authorities may be taken to be the *fair value.*
- If other assets are handed over, *fair value* may be determined by reference to the market value of assets given up.
- Where *market value* of assets given up *cannot be reliably assessed*, such assets may be valued at their respective *net book values*.

b) Adjustment of consideration – Future events

It is possible that a purchase or merger transaction is concluded on terms and conditions, that may include an element of consideration payable on a subsequent date, and conditional upon one or more future uncertain events materialising. Two possibilities can emerge:

- Such a conditional payment is probable, and amount can also be estimated. If affirmative, include the amount in the consideration.
- In all other cases, adjustment should be recognised as soon as the amount is determinable.

Consider the following example.

Situation	***Alternative I***	***Alternative II***
Conditional payment	Rs.10 Lakhs + 1% on sales for each of three following complete financial years	Rs.10 Lakhs + 1% on sales for each of three following complete financial years, minimum Rs.1 lac per annum
Aspects enquired into	1% on future sales not determinable	1% on future sales not determinable – but minimum amount determinable
Action	No need to include additional consideration at the time of purchase	Include additional consideration of Rs.3 Lakhs at the time of purchase

c) Treatment of reserves specified in the scheme of amalgamation

Company Law related issue (Refer to Sub clause (vi) of clause (b) of Section 394)

In a scheme of amalgamation, court approval is obtained at times. In such an event, the court is empowered to prescribe conditions to ensure that the scheme is fully and effectively carried out. The order may include conditions pertaining to "treatment of reserves" of SC after amalgamation. The Standard provides that if there is any such condition attached to the scheme, the treatment so prescribed should be followed.

In some cases, where the "court approved" terms enable an entity to treat "reserves" in a manner different from those laid down under AS 14, further disclosures should be made as under:

a) Description of accounting treatment given to reserves

b) Reason for following a treatment that differs from AS 14

c) Deviations in the accounting treatment given to reserves as prescribed by the scheme of amalgamation, sanctioned under the statute, as compared to the requirements of AS 14 that would have been followed, had no treatment been prescribed by the (court approved) scheme.

Disclosure Requirements

Prescriptions in the Standard cover three distinct areas:

For all Amalgamations

- Names, general nature of business of amalgamating companies, effective date
- Method of accounting
- Particulars of scheme – statutorily sanctioned
- *Amalgamation after B/S date (before issue of financial statements) disclose as per AS 4 – BUT NOT TO BE INCORPORATED IN FINANCIAL STATEMENTS*

For Pooling of interest – 1st Financial Statement

- Description and Number of shares issued
- % of equity shares exchanged to give effect to amalgamation
- Difference between consideration and NAV; treatment thereof

For Purchase method – 1st Financial Statement

- Consideration paid and contingently payable
- Difference between consideration and NAV; treatment thereof
- Amortisation period of goodwill (if any)

Amalgamation after Balance sheet date

The possibility of an amalgamation arrangement being concluded after balance sheet date (but before issue of financial statement) cannot be ruled out. Keeping this in view, the Standard provides two alert signals:

a) This will fall within the ambit of AS 4 (Events occurring after the balance sheet date). Hence, it must be disclosed.

b) On balance sheet date, the validity of "going concern" assumption may not be appropriate. However, a post-balance sheet event may allow the going concern assumption to be maintained.

Accounting for taxes on income

The committee vide *Interpretation Number 11* addressed the following issues relating the taxes on income in the case of an amalgamation.

a. In an amalgamation in the nature of purchase, the consideration for the amalgamation is allocated to the individual identifiable asset or liabilities on the basis of their fair values at the date of amalgamation as per AS 14, and the carrying amounts thereof for tax purposes continue to be the same as that for the transferor enterprise. The difference between the values of the assets or liabilities, constitutes a permanent difference. The consequent difference between the amounts of depreciation for accounting purposes and tax purposes in respect of such assets in subsequent years would also be permanent differences.

b. In a situation where any deferred tax asset, including in respect of unabsorbed depreciation and carry forward of losses, was not recognised by the transferor enterprise, because the conditions relating to prudence laid down in AS 22, were not satisfied, the transferee enterprise can recognise the same if the conditions relating to prudence as per AS 22 are satisfied.

Where the **"amalgamation is in the nature of purchase"** and the consideration for the amalgamation is allocated to individual identifiable assets or liabilities on the basis of their fair values at the date of amalgamation as recognised at existing carrying amount as permitted in AS 14, the deferred tax assets should be recognized by the transferee enterprise at the time of amalgamation itself considering these as identifiable assets. These deferred tax assets can be recognized at the time of amalgamation only if the conditions relating to prudence laid down in AS 22, are satisfied from the point of view of the transferee enterprise at the time of amalgamation. The recognition of deferred tax assets will automatically affect the amount of the goodwill or capital reserve arising on amalgamation.

In a case where the conditions for recognition of deferred tax assets as per AS 22 are not satisfied at the time of the amalgamation, but are satisfied by the first annual balance sheet date following the amalgamation, the deferred tax assets can be recognised. The corresponding adjustment should be made to the goodwill or capital reserve arising on the amalgamation. If, however, the conditions for recognition of deferred tax assets are not satisfied even by the first annual balance sheet date following the amalgamation, the corresponding effect of any subsequent recognition of the deferred tax asset on the satisfaction of the conditions should be given in the statement of profit and loss of the year in which the conditions are satisfied and not in the goodwill or capital reserve.

Where the "*amalgamation is in the nature of merger*", the deferred tax assets should not be recognised at the time of amalgamation. However, if, by the first annual balance sheet date subsequent to the amalgamation the unrecognised deferred tax assets are recognized, pursuant to satisfaction of conditions of reasonable or virtual certainity relating to reassessment of unrecognised deferred tax assets, the corresponding adjustment should be made to the revenue reserves. In a case where the conditions for recognition of deferred tax assets as per

AS 22 are not satisfied by the first annual balance sheet date following the amalgamation, the corresponding effect of any subsequent recognition of the deferred tax asset on the satisfaction of the conditions should be given in the statement of profit and loss of the year in which the conditions are satisfied and not in the revenue reserves.

Recognition by transferee on amalgamation of DTA not recognised by transferor for reason of absence of reasonable / virtual certainty

<table>
<tr><th>Conditions</th><th>Amalgamation in the Nature of Merger</th><th>Amalgamation in the Nature of Purchase</th></tr>
<tr><td>1. Conditions of reasonable / virtual certainty are satisfied at the time of amalgamation:</td><td></td><td></td></tr>
<tr><td>a) Assets and liabilities allocated on the basis of "fair values"</td><td rowspan="2">Not applicable i.e. DTA should not be recognised as assets and liabilities are recorded only at existing carrying amounts and the DTA is not appearing as an asset in the transferor books</td><td>a) DTA should be recognised. The recognition will automatically affect the amount of goodwill or capital reserve.</td></tr>
<tr><td>b) Assets and liabilities are recorded at existing carrying amounts.</td><td>b) DTA should not be recognised at the time of amalgamation</td></tr>
<tr><td>2. Conditions of reasonable / virtual certainty are satisfied only at the time of first balance sheet date after amalgamation:</td><td>DTA should be recognised by adjusting against revenue reserves.</td><td>DTA should be recognised by adjusting against goodwill or capital reserve.</td></tr>
<tr><td>3. Conditions of reasonable / virtual certainty are satisfied only subsequent to the first balance sheet date after amalgamation :</td><td colspan="2">DTA should be recognised by adjusting against Profit and loss A/c</td></tr>
</table>

AS 14 : A diagrammatic representation

Accounting for Amalgamations

The accounting treatment for acquisition of controlling interest is not covered.

Merger – Five conditions

1. Assets / liabilities of selling company = Assets / liabilities of purchasing company
2. 90% of Fair value of equity shareholders become shareholders of purchasing company - exclusions
3. Consideration in shares – cash for fractional shares
4. Intention to continue the business
5. No adjustment to book values; but for uniformity in accounting policies

Purchase

If any one of these five conditions is not met

Accounting

Pooling of interest method

- Difference in purchase consideration adjusted in Profit and loss account
- Profit and loss account balance does not lose its identity
- No goodwill

Accounting

Purchase Method

- Difference in purchase consideration
- Goodwill or Capital reserve
- Amortise =< 5 years

Pay attention to:

a) Non-cash consideration – Fair values
b) Considerations payable contingently
c) Merger or Purchase, post-balance sheet date (AS 4)
d) Conditions, if any, laid down by the Court while approving an amalgamation statutorily in respect of reserves, should be complied with.

Disclosures

- For all amalgamations
- For mergers
- For purchase

AS 14 and Companies Act

The Standard itself refers to the term “amalgamations” to mean an amalgamation pursuant to the provisions of the Companies Act. Section 394 of Companies Act, 1956 is relevant. Section 394 provides that a “transferor company” includes any body corporate, whether a company within the meaning of Companies Act, or not.

No disclosures are specified under Schedule VI for financial statements, after amalgamation of two or more companies. However, AS-14 prescribes disclosures in the areas of (a) name and general nature of business of amalgamating companies, (b) effective date of amalgamation, (c) method of accounting used to reflect the amalgamation, and (d) particulars of scheme sanctioned by statute. It also requires further disclosures based on the method followed for accounting for amalgamations.

AS 14 and Income Tax Act

(a) Meaning

The term ‘amalgamation’ is defined u/s 2(1B), only in relation to “companies”. The term means the merger of one or more “companies” with another company, or the merger of two or more companies to form one company (The company or companies which so merge being referred to as the amalgamating company or companies. The company with which they merge or which is formed as a result of the merger is referred to as the amalgamated company), in such a manner that:

- All the property of the amalgamating company or companies immediately before the amalgamation, becomes the property of the amalgamated company by virtue of the amalgamation.
- All the liabilities of the amalgamating company or companies immediately before the amalgamation, becomes the liabilities of the amalgamated company by virtue of the amalgamation.
- Shareholders holding not less than *three-fourths in value* of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation, otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

(b) Other areas

- *Section 35DD* implicitly recognises deferment of expenses of amalgamation and demerger for a period of five years, and provides for a deduction from income to the extent of $1/5^{th}$ of such expenditure for each of the five succeeding years. Writing off, for accounting purposes, such expenses in a single year (but gaining tax deduction thereon over a five year period) will give rise to *timing differences.*

- *Section 43C* covers tax implications and the manner in which cost of asset will be determined, in the area of transfer of properties of and by the amalgamated company as stock in trade
- Provisions under section *47(vi), (via), and (vii)* elaborate the circumstances in which capital gains would, or would not arise, for transfer of shares, relatable to amalgamation.
- *Section 72A* cover the conditions governing carry forward of unabsorbed depreciation or losses of amalgamating company in the books of amalgamated company

Provisions under the above sections focus on potential areas where timing differences can arise and compliance of *AS 22* will be required.

Comparison of AS 14 with IAS & US GAAP

AS 14	***IAS 22***	***US GAAP FAS 141***
Accounting for Amalgamations	Business combinations (originally issued in 1983 and revised in 1993, effective from January 1995)	Business Combinations
Broadly in line with IAS 22, and prescribes inclusion of contingently payable consideration if the adjustment is probable, and the amount can be measured	IAS draws a distinction between acquisition and uniting of interest. If the combination is one of exceptional cases in which an acquirer cannot be identified then it should be accounted for as a uniting of interests.	Both Purchase and Pooling of interest methods are acceptable in accounting for business combinations but not as an alternative for the same business combination. Prescribes attributes of combining companies and also elucidates on manner of the combination.

Supplemental information

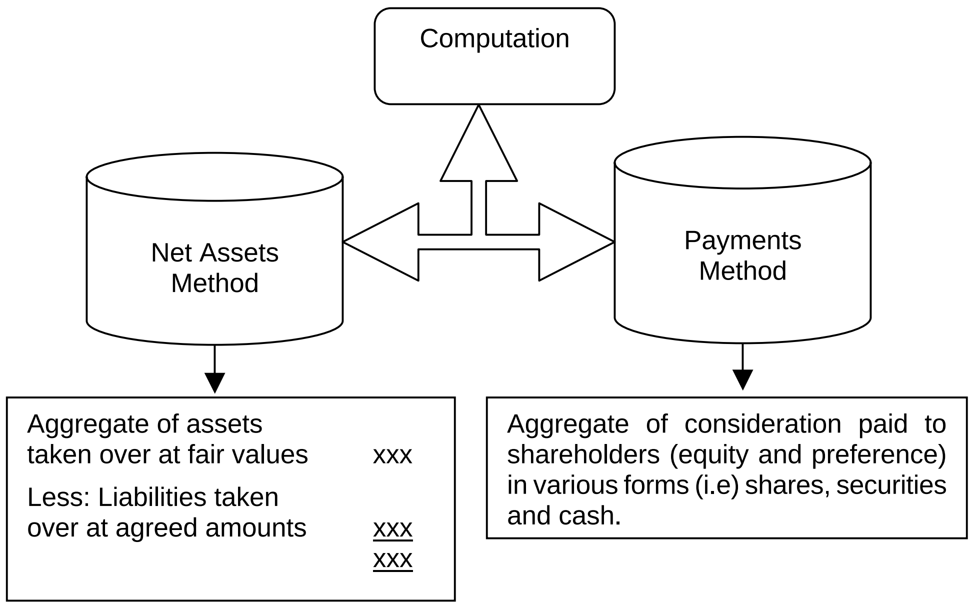
1. Taking note of practical situations and possibilities, ICAI has taken on hand a review of the need for continuation of “merger”, and accounting thereof under pooling of interest method. The rationale appears to be that amalgamations that take place are seldom in the nature of merger. Further pronouncements from ICAI in this regard are awaited.
2. For a better appreciation of AS-14, readers may also refer to AS-1 (Disclosure of Accounting Policies), Guidance Note on treatment of reserve created on revaluation of fixed assets and the prescriptions under AS 10 in respect of Goodwill, i.e. not to be recognised unless paid for.

Accounting For Amalgamations

Refer Problems 1 to 18

Section 1 :

A. Computation of Purchase consideration



B. Transferor Company Accounting

1. AS-14- Not applicable
2. Accounting is independent of nature of amalgamation (AS-14) and method of accounting in transferee company books.
3. Accounting is done with the objective of closing books of accounts and simultaneous determination of profit/loss on closing of books of account.

1. Transfer to Realisation A/c.

Particulars		*Debit Rs.*	*Credit Rs.*
a. Assets taken over by purchasing company at book values.			
Realisation A/c	Dr.	XXX	
To Assets A/c			XXX
b. Liabilities taken over by purchasing company at balance sheet value.			
Liabilities A/c	Dr.	XXX	
To Realisation A/c			XXX

2. **Purchase Consideration**

Purchase consideration represents consideration paid by transferee company to shareholders (equity and preference) in any form viz., cash, shares, debentures etc.

	Particulars		Debit Rs.	Credit Rs.
a.	*Due entry for consideration*			
	Transferee company A/c	Dr.	XXX	
	To Realisation A/c			XXX
b.	*Receipt of consideration*			
	Shares / securities of transferee company A/c	Dr.	XXX	
	Bank A/c	Dr.	XXX	
	To Transferee company A/c			XXX

3. **Sale of assets not taken over (Assuming Profits)**

Particulars		Debit Rs.	Credit Rs.
Bank A/c *(sale proceeds)*	Dr.	XXX	
To Asset A/c *(Book value)*			XXX
To Realisation A/c *(Profits)*			XXX

4 **Settlement of liabilities not taken over (Assuming at a discount)**

Particulars		Debit Rs.	Credit Rs.
Liabilities A/c *(book value)*	Dr.	XXX	
To Bank A/c *(amount paid)*			XXX
To Realisation A/c *(discount)*			XXX

5. **Realisation expenses**

	Particulars		Debit Rs.	Credit Rs.
a.	*Incurred by transferor company*			
	Realisation A/c	Dr.	XXX	
	To Bank A/c			XXX
b.	*Incurred by transferee company*			
	No Entry			
c.	*Incurred by transferor company reimbursed by transferee company*			
	i. On incurring the expenses			
	Transferee company A/c	Dr.	XXX	
	To Bank A/c			XXX
	ii. On reimbursement			
	Bank A/c	Dr.	XXX	
	To Transferee company A/c			XXX

6. **Amount due to equity Shareholders**

Particulars		*Debit Rs.*	*Credit Rs.*
a. *Transfer of share capital and reserves to shareholders account*			
Equity share capital A/c	Dr.	XXX	
Reserves A/c	Dr.	XXX	
To Shareholders A/c			XXX
b. *Transfer of balance in realisation account - Profit / loss (assuming profit)*			
Realisation A/c	Dr.	XXX	
To Shareholders A/c			XXX

7. Settlement to Shareholders by transfer of consideration received:

Particulars		*Debit Rs.*	*Credit Rs.*
Shareholders A/c	Dr.	XXX	
To Shares / securities of transferee company A/c			XXX
To Bank A/c			XXX

C. Transferee Company Accounting

1. Accounting should be done as provided in AS-14.
2. AS-14 classifies amalgamation for the purpose of accounting as:
   a. Amalgamation in the nature of merger.
   b. Amalgamation in the nature of purchase.
3. The nature of amalgamation is determined by putting the scheme of amalgamation to five tests or conditions. The five conditions being:
   a. All assets and outside liabilities of transferor company are transferred to transferee company.
   b. The assets taken over should be recorded in the transferee company books at the same values at which they appeared in the books of transferor company.

      Note: The assets may however be restated for purpose of ensuring uniformity of accounting policies. eg: Stock, Depreciation

   c. Atleast 90% in terms of nominal value of the outside shareholders become shareholders of the transferee company.
   d. The consideration to equity share holders of the transferor company shall be paid only in the form of equity shares of transferee company.

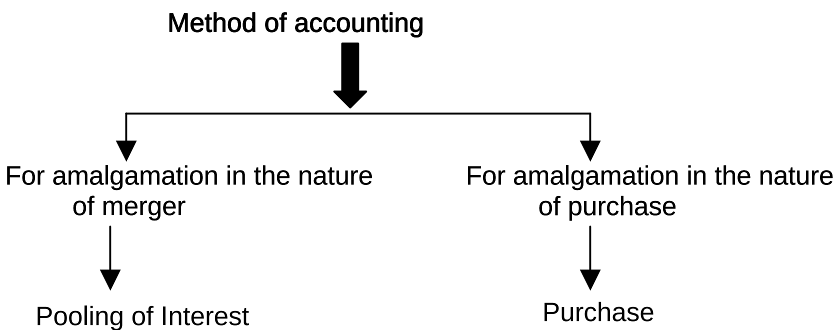
      Note: Cash may however be paid for fractions of shares.

e. The transferee company intends to carry on the business hitherto carried on by Transferor company.

A scheme of amalgamation satisfying all the above conditions is referred as "Amalgamation in the nature of **Merger**."

A Scheme of amalgamation, which does not satisfy **any or all** of the above Conditions, is referred as "Amalgamation in the nature of **Purchase**."

4. **Method of accounting:**



Purchase Method:

1. **Due entry for business purchased or acquired for which purchase consideration is payable to liquidator of transferor company**

Particulars		***Debit Rs.***	***Credit Rs.***
Business purchase A/c	Dr.	XXX	
To Liquidator of transferor company A/c			XXX

2. **Incorporation of assets and liabilities taken over**

Particulars		***Debit Rs.***	***Credit Rs.***
Assets A/c *(Agreed value)*	Dr.	XXX	
Goodwill A/c *(Balancing figure)*	Dr.	XXX	
To Liabilities A/c *(Agreed values)*			XXX
To Business purchase A/c *(Consideration)*			XXX
To Capital reserve A/c *(Balancing figure)*			XXX

The incorporation of assets and liabilities taken over results in either Goodwill or Capital Reserve determined as balancing figure.

- Goodwill – excess of consideration over net assets taken over
- Capital Reserve – excess of net assets over consideration.

3. Discharge of Consideration

Particulars		*Debit Rs.*	*Credit Rs.*
Liquidator of transferor company A/c	Dr.	XXX	
To Share capital A/c			XXX
To Securities premium A/c			XXX
To Bank A/c			XXX

4. Others

Particulars		*Debit Rs.*	*Credit Rs.*
a. *Cancellation of inter company owings*			
(Eg) Debtors / Creditors			
Creditors A/c	Dr.	XXX	
To Debtors A/c			XXX
b. *Elimination of unrealised profits on goods sold by one company to the other and remaining unsold on the date of amalgamation*			
Goodwill / Capital reserve A/c	Dr.	XXX	
To Stock reserve / Stock A/c			XXX
c. *Realisation expenses*			
Alternative 1 : Incurred by purchasing company			
Goodwill / Capital reserve A/c	Dr.	XXX	
To Bank A/c			XXX
Alternative 2 : Realisation expenses incurred by selling company			
No Entry			
Alternative 3 : Realisation expenses incurred by selling company but reimbursed by purchasing company.			
Goodwill / Capital reserve A/c	Dr.	XXX	
To Bank A/c			XXX

5. Contra Entry for Statutory reserve appearing in selling company books for which obligations are yet to be fulfilled.

Particulars		*Debit Rs.*	*Credit Rs.*
Amalgamation adjustment A/c	Dr.	XXX	
To Statutory reserve A/c			XXX

Note:
a. Statutory reserve should be shown as part of reserves and surplus in amalgamating company balance sheet.
b. Balance in amalgamation adjustment account shown on the asset side under the head "Miscellaneous expenditure to the extent not written off".
c. This entry is reversed as and when the obligations are fulfilled.

Pooling of Interest Method:

1. Due entry for business acquired (for purchase consideration)

Particulars		*Debit Rs.*	*Credit Rs.*
Business purchase A/c	Dr.	XXX	
To Liquidator of selling company A/c			XXX

2. Incorporation of assets and liabilities taken over

a. Assets and liabilities of selling company taken over are to be recorded at same values at which they appeared in selling company's books.

b. The reserves of selling company are also to be incorporated subject to adjustments given below.

c. The difference between purchase consideration and paid up capital (equity and preference) of selling company is to be adjusted as under:

(i) Excess of consideration paid over paid up share capital (equity and preference) is to be adjusted against:

- ➢ Free reserves of selling company
- ➢ Secondly against free reserves of purchasing company
- ➢ Lastly, debit Profit and loss A/c.

Note : The sequence is usually specified in the "Scheme of Amalgamation"

(ii) Where the consideration paid is less than paid up share capital, the difference is to be credited to capital reserves of selling company while incorporation.

<u>Illustration:</u>

Balance sheet of selling company

Liabilities		Rs.	Assets	Rs.
Share capital		50	Total assets	150
Reserves				
Free reserves	45			
Statutory reserve	5	50		
Outstanding liabilities		50		
Total		**150**	**Total**	**150**

Consideration

(Rs.)

I	II	III	IV
50	90	110	40

Treatment of reserves

(Rs.)

		I	II	III	IV
1.	Consideration	50	90	110	40
2.	Paid up share capital of transferor company (equity & preference)	50	50	50	50
3.	Excess of 1 over 2	-	40	60	(10)
4.	Adjustment of above excess (3) against				
	a. Free reserves of transferor company	-	(40)	(45)	-
	b. Free reserves of transferee company	-	-	(15)	-
5.	Balance of selling company reserves to be incorporated .				
	a. Free reserves	45	5	-	45
	b. Statutory reserves	5	5	5	5
	c. Capital reserve*	-	-	-	10

* Expert Advisory Committee Opinion - 2004. [Refer Problem 5]

Alternative - 1:

Particulars		Debit Rs.	Credit Rs.
Assets A/c	Dr.	150	
To Liabilities A/c			50
To Free reserves A/c			45
To Statutory reserves A/c			5
To Business purchase A/c			50

Alternative - 2:

Particulars		Debit Rs.	Credit Rs.
Assets A/c	Dr.	150	
To Liabilities A/c			50
To Free reserves A/c			5
To Statutory reserves A/c			5
To Business purchase A/c			90

Alternative - 3:

Particulars		*Debit Rs.*	*Credit Rs.*
Assets A/c	Dr.	150	
Reserves or Profit and loss A/c	Dr.	15	
To Liabilities A/c			50
To Free reserves A/c			Nil
To Statutory reserves A/c			5
To Business purchase A/c			110

Alternative - 4:

Particulars		*Debit Rs.*	*Credit Rs.*
Assets A/c	Dr.	150	
To Liabilities A/c			50
To Free reserves A/c			45
To Statutory reserves A/c			5
To Capital reserve A/c			10
To Business purchase A/c			40

3. Discharge of consideration

Particulars		*Debit Rs.*	*Credit Rs.*
Liquidator of selling company A/c	Dr.	XXX	
To Share capital A/c (Paid up value)			XXX
To Securities premium A/c			XXX
To Bank A/c (fractions)			XXX

4. Cancellation of inter company owings – Same as in purchase method

5. Creation of reserves for unrealised profit on unsold goods part of inter company transactions

Particulars		*Debit Rs.*	*Credit Rs.*
Reserves or Profit and loss A/c	Dr.	XXX	
To Stock reserve A/c			XXX

6. Realisation expenses – Incurred by purchasing company or reimbursed by purchasing company

Particulars		*Debit Rs.*	*Credit Rs.*
Reserves or Profit and loss A/c	Dr.	XXX	
To Bank A/c			XXX

Note: (General)

a. In this method, ordinarily neither Goodwill A/c nor Capital Reserve A/c will arise on account of business being taken over.

b. Statutory reserves are incorporated at the time of recording assets and liabilities taken over and consequently no contra entry is passed as in purchase method. Hence amalgamation adjustment account does not arise.

c. The paid up capital against which consideration is compared is the aggregate of paid up value of equity share capital and preference capital.

Section II:

Inter Company Holdings - Purchasing Company in Selling Company

Refer Problems 19 to 25

Balance Sheet of P Ltd.

Liabilities	Rs.	Assets	Rs.
		Investment 20,000 shares of S Ltd.	

Balance Sheet of S Ltd.

Liabilities	Rs.	Assets	Rs.
Share capital 1,00,000 shares of Rs. 10 each			

- Extent of purchasing company (P Ltd.) interest in selling company (S Ltd.) - 20%
- Fair value of net assets of S Ltd. - Rs. 40 Lakhs
- Exchange ratio - 2 for every 1 share of S Ltd.
- Issue price of P Ltd. shares - Rs. 20/-

A. Computation of consideration

Consideration is to be calculated only with reference to outside shareholders since purchasing company already holds some shares of selling company.

Net assets method:

Step -1:

Compute net assets of business as a whole - Rs. 40 Lakhs

Step -2:

Ascertain proportion of net assets belonging to outside shareholders, which represents the consideration on the basis of which entries are recorded. (Net purchase consideration) - Rs. 32 Lakhs

Step -3:

Determine mode of discharge of above consideration (Step 2) - 1.6 Lakhs share @ Rs. 20/-

Payments method:

Step -1:

Ascertain number of outside shareholders - 80,000 shares

Step -2:

Consideration is arrived as the aggregate of payments in various forms to the outside shareholders at agreed exchange ratios 2:1

$$80{,}000 \times \frac{2}{1} = 1{,}60{,}000 \times \text{Rs. } 20/- = \text{Rs. } 32{,}00{,}000/-$$

B. Accounting - Books of transferor company

1. Transfer to realisation account.
   a. All assets taken over at book value.
   b. Liabilities taken over at balance sheet value.
2. Purchase consideration – for outsiders only
   a. Due entry
   b. Receipt entry

3. **Cancellation** of paid up share capital to the extent of purchasing company interest

Particulars		*Debit Rs.*	*Credit Rs.*
Share capital A/c (Paid up)	Dr.	XXX	
To Realisation A/c			XXX

4. **Amount due to outside shareholders**

   a. Share capital **(remaining capital after cancellation)** and reserves in full.

   Note: Reserves to the extent of purchasing company interest is also included in the above reserves since the impact on amount due to outside share holders remains the same even if prorata share of reserves is transferred to realisation a/c since realisation profit will increase by the same amount.

   b. Realisation Profit or Loss

5. **Settlement to shareholders by transfer of consideration received.**

C. Accounting - Books of transferee company

1. Due entry for consideration to outside shareholders of transferor company.

2. Incorporation of assets and liabilities taken over including **cancellation** of investments held by purchasing company in selling company.

Purchase method (excluding inter company investments)

Particulars		*Debit Rs.*	*Credit Rs.*
Assets A/c *(Agreed value)*	Dr.	XXX	
Goodwill A/c (*Balancing figure)*	Dr.	XXX	
To Liabilities A/c *(Agreed value)*			XXX
To Business purchase A/c *(Consideration)*			XXX
To Investment in selling company A/c *(Book value)*			XXX
To Capital reserve A/c *(Balancing Figure)*			XXX

Pooling of Interest Method

a. Ascertain difference between paid up capital of selling company (Equity and preference) and aggregate of:

   i. Purchase consideration – Outsiders interest

   ii. Investments held by purchasing company in selling company

b. Above excess or shortfall to be adjusted as discussed earlier against:

i. Free reserves of selling company

ii. Free reserves of purchasing company

iii. Profit and loss A/c

Particulars		*Debit Rs.*	*Credit Rs.*
Assets A/c *(excluding inter company investments)* *(Book value of selling company)*	Dr.	XXX	
Reserves or Profit and loss A/c of purchasing company	Dr.	XXX	
To Liabilities A/c			XXX
To Reserves of selling company A/c			XXX
To Business purchase (consideration) A/c			XXX
To Investment in selling company A/c			XXX

3. Discharge of consideration

4. Contra entry for Statutory reserves - Purchase method only

Other adjustments – Common for both methods

1. Cancellation of inter company owings	}	Same
2. Creation of reserve for unrealised profit	}	as
3. Realisation expenses incurred by purchasing company	}	earlier

Note : **Revaluation of investments already held by purchasing company in selling company**

Revaluation is to be done only when specified. It is normally done where the investments were acquired as current investment or non trade investment. The Profit or Loss on revaluation is recognised in Profit and loss A/c as a pre amalgamation event.

Journal entry (assuming profit)

Particulars		*Debit Rs.*	*Credit Rs.*
Investment in selling company A/c	Dr.	XXX	
To Profit and loss A/c			XXX

Where investments are revalued, such revalued amounts should be considered while cancelling the investments at the time of incorporation of assets and liabilities.

Section III:

Inter Company Holdings - Selling Company in Purchasing Company

Refer Problems 26 to 28

Balance sheet of P Ltd.

Liabilities	Rs.	Assets	Rs.
Share capital 1,00,000 shares of Rs. 10 each	10,00,000		

Balance sheet of S Ltd.

Liabilities	Rs.	Assets	Rs.
Share capital	1,00,000	Investments 10,000 shares in P Ltd.	

- Net assets of S Ltd. excluding inter company investment - Rs. 38,00,000
- Fair value of P Ltd. Shares - Rs. 20/-
- Exchange ratio - 2 for every 1 share of S Ltd.
- Issue price of P Ltd. shares - Rs. 20/-

A. Purchase consideration:

Net assets method:

Step -1:

Calculate net asset of business as a **whole** by considering the agreed values or fair values; including investment of selling company in purchasing company at fair value

Rs. 38,00,000 + (10,000 shares x Rs. 20) = Rs. 40,00,000

Step -2:

Determine the mode of discharge for above net assets viz., number of shares / securities and cash = $\frac{40,00,000}{20}$ = 2,00,000 shares of P Ltd.

Step -3:

Deduct number of shares already held by selling company in purchasing company. (Since purchasing company cannot take over shares in its own company - Sec. 77) = 10,000 shares.

Step -4:

Purchase consideration is the aggregate of:

		Rs.
a.	Net number of shares arrived above (Step 2-3) at agreed price (1,90,000 x 20)	38,00,000
b.	Securities	-
c.	Cash.	-
		38,00,000

Payments method:

Step -1:

Calculate number of shares to be issued by purchasing company to shareholders of selling company at the agreed exchange ratio

$$= 1,00,000 \times \frac{2}{1} = 2,00,000 \text{ shares of P Ltd.}$$

Step -2:

Deduct number of shares already held by selling company in purchasing company = 10,000 shares

Step -3:

Purchase consideration is the aggregate of:

		Rs.
a)	Net number of shares arrived above (Step 2-3) at agreed price (1,90,000 x 20)	38,00,000
b)	Securities	-
c)	Cash	-
		38,00,000

Accounting - Books of transferor company

1. **Transfer to realisation account**

   a. All assets taken over **except investments** held by selling company in purchasing company

   b. Liabilities taken over

2. **Purchase consideration**

   a. Due entry

   b. Receipt entry

3. **Realisation of assets not taken over**

4. **Settlement of liabilities not taken over**

5. **Amount due to shareholders**

   a. Share capital

   b. Reserves and surplus

   c. Realisation Profit or loss

6. **Settlement to shareholders by transfer of:**

   a. Purchase consideration received

   b. Shares already held by selling company in purchasing company

Particulars		***Debit Rs.***	***Credit Rs.***
Shareholders A/c	Dr.	XXX	
To Equity share of transferee company A/c			XXX
To Bank A/c			XXX

Note : Inter company investments should be revalued only if required in the problem. The revaluation is usually done where investment is acquired as a current / non-trade investment.

Accounting - Books of transferee company

1. Due entry for purchase consideration – same
2. Incorporation of assets and liabilities taken over

Purchase method:

Particulars		*Debit Rs.*	*Credit Rs.*
Assets A/c *(Agreed value)*	Dr.	XXX	
Goodwill A/c *(Balancing figure)*	Dr.	XXX	
To Liabilities A/c *(Agreed value)*			XXX
To Business purchase *(Consideration)*			XXX
To Capital reserve *(Balancing figure)*			XXX

Pooling of interest method

a. Ascertain difference between paid up capital of selling company and aggregate of:
   i. Purchase consideration
   ii. Investments held by selling company in purchasing company.

b. The excess or shortfall in above step is to be adjusted against:
   i. Free reserves of selling company
   ii. Free reserves of purchasing company
   iii. Profit and loss A/c

Particulars		*Debit Rs.*	*Credit Rs.*
Assets A/c *(Book Value)*	Dr.	XXX	
Reserves A/c	Dr.	XXX	
To Liabilities A/c			XXX
To Reserves of selling company A/c			XXX
To Business purchase A/c			XXX

3. Discharge of consideration

4. Contra entry for statutory reserves - only purchase method

Other Items – Common to both

1. Cancellation of inter company owings
2. Creation of stock reserve
3. Realisation expenses

Same as earlier

Section IV: Cross Holdings

(Purchasing company and selling company hold shares in each other)

Refer Problems 29 to 30

Balance sheet of P Ltd.

Liabilities	Rs.	Assets	Rs.
Share capital	5,00,000	Investment of shares in S Ltd. 8,000 shares	

Balance sheet of S Ltd.

Liabilities	Rs.	Assets	Rs.
Share capital	1,00,000	Investments 10,000 shares in P Ltd.	

A. Purchase consideration

Net assets method

Step -1:

Compute net assets of selling company:

Particulars	*Rs.*
a. Aggregate of all assets at fair or agreed value	XXX
b. Less : Liabilities taken over	XXX
c. Net assets of selling company	XXX

Step -2:

Determine the proportion of net assets pertaining to outside shareholders.

Step -3:

Determine the mode of consideration: Number of Shares, other securities and cash payable to the outside shareholders (amount in step-2).

Step -4:

Deduct number of shares already held by selling company in purchasing company.

Step -5:

The net of Step-4 and Step-5 i.e., net number of shares at agreed price per share together with other securities and cash constitutes the value of consideration to be recorded.

Payments Method

Step -1:

Determine on the basis of exchange ratio agreed, the number of shares to be issued by purchasing company to the **outside shareholders** of selling company.

Step -2:

Deduct number of **shares already held** by selling company in purchasing company.

Step -3:

The net number of shares arrived at (Step-1 & Step-2) at the agreed price together with other securities and cash constitutes **Purchase consideration** to be recorded.

Note: In the following situations, simultaneous ***linear equations*** are to be constructed to compute purchase consideration.

a. Consideration calculated in net ***assets method*** since one of the assets to be considered is investments held by selling company in purchasing company.

b. Where consideration is discharged by the purchasing company at its *intrinsic value* since the value of its to be arrived at after considering purchasing company's investment in selling company.

c. If investment held is to be *revalued* on the basis of intrinsic value before amalgamation.

Accounting - Books of transferor company

1. Transfer to realisation A/c
    a. All assets **except** investments held by selling company in purchasing company.
    b. Transfer of liabilities
2. Purchase consideration
    a. Due entry
    b. Receipt entry

3. **Cancellation** of paid up share capital (purchasing company's interest in selling company)

Particulars		***Debit Rs.***	***Credit Rs.***
Share capital A/c (paid up)	Dr.	XXX	
To Realisation A/c			XXX

4. **Amount due to remaining shareholders (Outsiders)**
   a. Share capital after cancellation as above
   b. Reserves and surplus
   c. Realisation profit or loss

5. **Settlement to shareholders by transfer of:**
   a. Consideration received
   b. Investments already held

Accounting - Books of Transferee Company

1. Due entry for purchase consideration
2. Incorporation of assets and liabilities **including cancellation of investments** held by purchasing company in selling company.

   Purchase method:

Particulars		***Debit Rs.***	***Credit Rs.***
Assets A/c *(Agreed value)*	Dr.	XXX	
Goodwill A/c *(Balancing figure)*	Dr.	XXX	
To Liabilities A/c *(Amounts taken over)*			XXX
To Business purchase A/c *(Consideration)*			XXX
To Investments of purchasing company in selling company *(Book value)*			XXX
To Capital reserve *(Balancing figure)*			XXX

Pooling of interest method:

a. Ascertain difference between paid up capital of selling company and aggregate of ;
   i) Consideration,
   ii) Investments by purchasing company in selling company and
   iii) Investments by selling company in purchasing company
b. The excess or shortfall arrived at in "a" above should be adjusted against:
   i) Free reserves of selling company
   ii) Free reserves of purchasing company
   iii) Profit and loss A/c – Debit

Particulars		*Debit Rs.*	*Credit Rs.*
Assets A/c *(Book Value)*	Dr.	XXX	
Reserves / Profit and loss of purchasing company A/c	Dr.	XXX	
To Liabilities A/c			XXX
To Statutory reserve of selling company A/c			XXX
To Free reserves of selling company A/c *(Subject to adjustments)*			XXX
To Business purchase A/c *(Consideration)*			XXX
To Investment of purchasing company in selling company A/c (Book value)			XXX

3. Discharge of consideration
4. Other items – Common to both
   a. Cancellation of inter company owings
   b. Creation of stock reserve
   c. Realisation expenses

   } Same as earlier

Payment method

Illustration :

a.	No. of shares in S Ltd.	1,00,000
b.	No. of shares in P Ltd.	10,00,000
c.	No. of shares held by S Ltd. in P Ltd.	30,000
d.	No. of shares held by P Ltd. in S Ltd.	20,000
e.	P Ltd. agreed to issue 2 shares for every 1 share in S Ltd.	

<u>Consideration</u>

a.	No. of shares in S Ltd.	1,00,000
b.	Less : Shares held by P Ltd.	(20,000)
		------------
c.	No. of shares held by outsider	80,000
d.	No. of shares agreed to be issued 2 shares for every 1 share i.e. 80,000 x 2	1,60,000
e.	Less : Shares already held by S Ltd.	(30,000)
		-------------
f.	No. of shares to be issued	1,30,000

No. of shares in P Ltd. after amalgamation

a.	No. of shares before Amalgamation	10,00,000
b.	Add : Shares issued to S Ltd.	1,30,000
		-------------
c.	Total no. of shares after amalgamation	11,30,000

Topic 2 : Reconstruction

Enterprises which run into sickness (losses) fall in either of the following categories.

a. Category I - Future is bleak. Remedy - Wind up the entity

b. Category II - Future prospects are good due to change in government policy, change in market demand etc.

The appropriate action is to continue business, capitalise on future prospects and recover all past losses. However, continuing business would require support from all stakeholders, in particular, from creditors and lenders. Such support would come only if the financial position looks healthy and is cleaned of all sickness (wiping off losses). This exercise is referred to as **reconstruction**.

Financial reconstruction is an exercise of restating assets and liabilities with a view to:

a. generate surplus (profits) to write off accumulated losses / abnormal losses

b. raise cash to facilitate turnaround (adding balancing equipment., upgrading assets to usable condition, modernisation etc.,)

Alternatives for reconstruction :

1. External reconstruction : Closing the entity and transferring assets and liabilities to another entity (usually new entity) pursuant to a scheme of amalgamation. The Accounting is same as amalgamation.
[Refer problem 38]

2. Internal reconstruction : Reoganisation within the entity by restating assets and liabilities and using the surplus for writing off losses.
[Refer problems 32 to 36]

Internal reconstruction – Journal entries

1. Assets:

a. Revaluation (Assuming profit)

Particulars		*Debit Rs.*	*Credit Rs.*
Assets A/c	Dr.	XXX	
To Reconstruction A/c			XXX

b. Sale of unproductive assets (Assuming profit)

Particulars		*Debit Rs.*	*Credit Rs.*
Bank A/c *(Sale proceeds)*	Dr.	XXX	
To Assets A/c (*Book value*)			XXX
To Reconstruction A/c (*Profit*)			XXX

c. Transfer of asset to creditors in discharge of liabilities (Assuming liability discharged is greater than book value of the asset)

Particulars		*Debit Rs.*	*Credit Rs.*
Liability A/c	Dr.	XXX	
To Assets A/c			XXX
To Reconstruction A/c			XXX

2. Outside liabilities

a. Waiver

Particulars		*Debit Rs.*	*Credit Rs.*
Liability A/c	Dr.	XXX	
To Reconstruction A/c			XXX

b. Settlement at discount

Particulars		*Debit Rs.*	*Credit Rs.*
Liability A/c	Dr.	XXX	
To Bank A/c			XXX
To Reconstruction A/c (*Discount*)			XXX

c. Conversion of one class of liability into another class (Assuming unsecured creditors converted into secured debentures at a lower value)

Particulars		*Debit Rs.*	*Credit Rs.*
Unsecured creditors A/c	Dr.	XXX	
To Secured debentures A/c			XXX
To Reconstruction A/c			XXX

3. Shareholders

a. Reduction of capital

Particulars		*Debit Rs.*	*Credit Rs.*
i. Reduction in number of shares			
Share capital A/c	Dr.	XXX	
To Reconstruction A/c			XXX
(to the extent of reduction)			

Particulars		Debit Rs.	Credit Rs.
ii. ***Reduction in paid up value***			
Share capital A/c *(Old face value)*	Dr.	XXX	
To Share capital A/c *(New face value)*			XXX
To Reconstruction A/c			XXX

Note : Another alternative of reduction is surrender of shares - discussed later.

b. Fresh issue of shares – normal share issue entries.

4. Utilisation of reconstruction surplus for:

a. Writing off accumulated losses

b. Writing off intangible assets and other assets which are overstated

Particulars		Debit Rs.	Credit Rs.
Reconstruction A/c	Dr.	XXX	
To Profit and loss A/c			XXX
To Assets A/c			XXX

5. Unutilized reconstruction surplus if any – transferred to capital reserve

Particulars		Debit Rs.	Credit Rs.
Reconstruction A/c	Dr.	XXX	
To Capital reserve			XXX

Presentation/Disclosure requirements:

1. The narration for the journal entries should specify the authority for scheme of reconstruction.

2. Name of the company after capital reduction (Particularly in cases where the capital is reduced because of accumulated losses to end with the words “and reduced”).

3. The balance sheet prepared after reconstruction should contain the information regarding assets and liabilities restated, extent of adjustment and authority of the scheme.

Surrender of Shares (alternative to capital reduction)

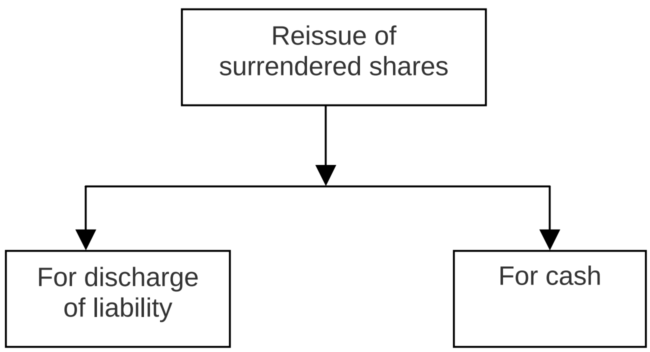
Refer Problem 39

1. **Shares surrendered:**

Particulars		*Debit Rs.*	*Credit Rs.*
Share capital A/c	Dr.	XXX	
To Share surrendered A/c			XXX

Note : Only fully paid share can be surrendered. The shares surrendered could be either equity shares or preference shares.

2. **Reissue of Surrendered shares:**



For discharge of liability

a. Transfer of shares surrendered in the name of creditors

Particulars		*Debit Rs.*	*Credit Rs.*
Share surrendered A/c	Dr.	XXX	
To Share capital A/c			XXX

b. Cancellation of liability discharged pursuant to issue of above shares

Particulars		*Debit Rs.*	*Credit Rs.*
Liability A/c	Dr.	XXX	
To Reconstruction A/c			XXX

For cash

a. Transfer of shares surrendered in the name of applicant

Particulars		*Debit Rs.*	*Credit Rs.*
Share surrendered A/c	Dr.	XXX	
To Share capital A/c			XXX

b. Cash received from applicants represents entirely profit and hence transferred to Reconstruction

Particulars		*Debit Rs.*	*Credit Rs.*
Bank A/c	Dr.	XXX	
To Reconstruction A/c			XXX

Note: The shares surrendered when reissued could be either:

a. Shares of the same class (original) OR

b. Shares of a different class

3. Cancellation of shares surrendered not reissued

Particulars		*Debit Rs.*	*Credit Rs.*
Share surrendered A/c	Dr.	XXX	
To Reconstruction A/c			XXX

Topic 3 : Demerger / HIVING OFF / SPIN OFF

Demerger refers to hiving off of a part of a business to another entity.

Refer Problems 40 to 44

Alternatives for demerger

Sale of part of business → Consideration received directly by transferor company → Profit/Loss on sale of part of undertaking represents capital profit or capital loss

Transfer of part of business pursuant to scheme of arrangement → Consideration discharged by purchasing company directly to members of selling company → Selling Company to cancel the value of net assets transferred for which consideration has been paid directly to members. → Scheme usually provides for simultaneous reduction of capital.

Accounting in books of transferor company

1. **Sale of undertaking** – Assuming Consideration is greater than net assets transferred

	Particulars		*Debit Rs.*	*Credit Rs.*
a.	*Due*			
	Purchasing company A/c (*Consideration*)	Dr.	XXX	
	Liability A/c	Dr.	XXX	
	To Assets A/c			XXX
	To Capital reserve A/c			XXX
b.	*Receipt of consideration*			
	Bank / Shares in purchasing company A/c	Dr.	XXX	
	To Purchasing company A/c			XXX

2. Scheme of arrangement - Transfer of business

Particulars		*Debit Rs.*	*Credit Rs.*
a. *Net assets taken over by Purchasing company – assuming consideration greater than net assets transferred*			
Purchasing company A/c (*Consideration*)	Dr.	XXX	
Liability A/c	Dr.	XXX	
To Assets A/c			XXX
To Members A/c			XXX
b. *Cancellation of amount receivable from purchasing company since the purchasing company discharges consideration directly in favour of members of selling company.*			
The amount receivable is cancelled against balance in members A/c (as per (a.) above)			
Members A/c	Dr.	XXX	
Reserves A/c	Dr.	XXX	
Reconstruction A/c	Dr.	XXX	
To Purchasing company A/c			XXX
c. *Balance in member A/c, if any, representing capital profit is to be transferred to capital reserve.*			

Accounting in books of transferee Company

The accounting is similar to accounting for acquiring business on amalgamation. The provisions of AS 14 are however not applicable.

1. Due entry for consideration

Particulars		*Debit Rs.*	*Credit Rs.*
Business purchase A/c	Dr.	XXX	
To Transferor company / Members of transferor company A/c			XXX

2. Incorporation of assets and liabilities taken over

Particulars		*Debit Rs.*	*Credit Rs.*
Assets A/c (Agreed values)	Dr.	XXX	
Goodwill A/c (Balancing figure)		XXX	
To Liabilities A/c *(Amounts taken over)*			XXX
To Business purchase A/c *(Consideration)*			XXX
To Capital reserve A/c *(Balancing figure)*			XXX

3. Discharge of consideration

Particulars		*Debit Rs.*	*Credit Rs.*
Transferer company / Member of transferor company A/c	Dr.	XXX	
To Share Equity / Debentures A/c			XXX

4. Other Items

a. Cancellation of Inter company owing
b. Creation of stock reserve
c. Realisation expenses

$\Big\}$ Against Goodwill or Capital reserve as the case may be

Accounting for Buy back of shares

Refer Problems 47 to 49

Caveat : This explanatory note is limited to the extent of explanation to quantitative restriction of buy back. (Section 77A of the Companies Act, 1956) and accounting treatment. It is to be noted that there is no technical pronouncement on accounting for buy back.

Determination of quantum for buy back - Section 77A

The maximum number of shares to be bought back is determined as the least of 'number of shares' arrived by performing the following tests :

1. Share outstanding test
2. Resource test
3. Debt equity ratio test.

1. **Share outstanding test :**

   a. Ascertain the number of shares (Paid up share capital)

   b. 25% of the number of shares is eligible for buy back with the approval of share holders[1].

2. **Resource test :**

   a. Ascertain shareholders funds (Paid up capital + free reserves)

   b. Ascertain number of shares as follows

$$= \frac{\text{Share holders funds}}{\text{Buy back price}}$$

3. **Debt equity ratio test :**

   After buy back, the company has to maintain a debt equity ratio[2] of 2:1

   a. Compute total borrowed funds

   b. Ascertain the minimum equity (shareholders funds)

   c. Ascertain present equity (share holders funds)

   d. Compute maximum possible dilution in equity i.e Step b - Step c

   e. Calculate the number of shares

$$= \frac{\text{Amount in Step d}}{\text{Buy back price}}$$

Buy back :

On determination of quantum of buy back, the shares are bought from public at the buyback price. The shares bought back has to be cancelled within 7 days from the buy back. The amount paid in excess of the cost of the share will be debited to reserves after adjusting against securities premium, if any available. A transfer is to be made to capital redemption reserve equivalent to capital redeemed.

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1. As per the companies (Amendment) Act, 2001, the Board of directors can buy back 10% of the number of shares without the approval of share holders.
2 . However, with the central government approval, the ratio may be relaxed.

Accounting - Buy back of shares

	Particulars		*Debit Rs.*	*Credit Rs.*
a.	On purchase of shares :			
	Shares bought back A/c	Dr.	XXX	
	To Bank A/c			XXX
	[Being purchase of shares from public]			
b.	Cancellation of shares bought back :			
	Share capital A/c	Dr.	XXX	
	Reserves A/c	Dr.	XXX	
	To Shares bought back			XXX
	[Being cancellation of shares bought on buy back]			
c.	Transferring the reserves to the extent share capital is redeemed			
	Reserves A/c	Dr.	XXX	
	To Capital redemption reserve A/c			XXX
	[Being transfer of reserves to capital redemption reserve to the extent capital is redeemed]			